

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

NOTICE OF MARKET-DOMINANT
PRICE ADJUSTMENT

Docket No. R2013-10

**RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO QUESTION 1 OF CHAIRMAN'S INFORMATION REQUEST NO. 2**
(October 16, 2013)

The Postal Service hereby files its response to question 1 of Chairman's Information Request No. 2, issued on September 30, 2013. The question is stated verbatim, and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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1. For the following discounts the Postal Service cited, in part, the Exigency Request in support of its 3622(e)(2) exception:

First-Class Mail Discounts

- (1) Mixed AADC Automation Cards;
- (2) AADC Automation Cards; and
- (3) ADC Automation Flats

Standard Mail Discounts

- (4) Nonautomation ADC Nonmachinable Letters;
- (5) Nonautomation 3-digit Nonmachinable Letters;
- (6) Automation 5-digit Flats;
- (7) Nonautomation 5-digit Flats; and
- (8) NDC irregular parcels.

Please provide revised discounts or revised justifications that are independent of the pending Exigency Request.

RESPONSE:

In compliance with the Commission's request, the Postal Service provides the independent justifications for the above-listed passthroughs. Though the Postal Service considers it prudent to evaluate passthrough adjustments based on the combined effects of the CPI-based and exigent-based price adjustments, the above passthroughs can be justified without reference to the Exigent case, under the efficient operations exception provided in 39 U.S.C. § 3622(e) (2) (D).

Two primary factors influenced the Postal Service's decisions to allow the affected passthroughs to remain above 100 percent: 1) the volatility of past estimates of avoided costs; and 2) the potential effects on mailer behavior arising from the size of the price increases required to reduce the passthroughs to 100 percent. In this regard, the Postal Service was further influenced by the importance of having predictable mailer behavior in the face of continuing changes in its processing network. Such network changes have been designed based on consistent and predictable historical patterns of

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mail flow and mailer practices. Sudden, erratic, or inconsistent practices affecting mail entry and processing requirements could affect the logic of such operational decisions, at least in the short term.

Confronted with these realities, and given its responsibility for day-to-day operational decisions, the Postal Service was concerned that additional price adjustments (to reduce the passthroughs to 100 percent, and keep them there) could end up sending inconsistent and frequently changing price signals to mailers that could ultimately impact the efficient operations of Postal Service.¹ The Postal Service will be mindful, however, to move the affected passthroughs toward 100 percent in future price adjustments

The Postal Service discusses the justification for each passthrough in more detail below. In addition, the table submitted as Attachment A to this pleading summarizes how far prices would need to increase in this price adjustment (above the average mail class increase) to reduce certain passthroughs to 100 percent. Attachment A also shows that in this docket the Postal Service has already used above-average price increases to move the passthroughs closer to 100 percent.

¹ For example, in the past, the vast majority of Processing and Distribution Facilities/Centers (P&DFs and P&DCs) housed both originating and destinating operations. As letter and card volumes have decreased over time, however, the Postal Service has realigned those operations so that fewer plants now contain both originating and destinating operations. To the extent that further adjustments in workshare discounts reduce mailers' incentive to enter more finely presorted mail, and that such mail is entered at facilities with only destinating operations, additional mail processing and transportation costs would be incurred in order to transport the less finely presorted mail to a facility that houses originating operations.

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First-Class Mail Discounts

1. Mixed AADC Automation Cards

In this Docket, the passthrough for Mixed AADC Automation Cards has been reduced from 227.3 percent to 136.4 percent. This reduction is the result of a 3.1 percent price increase for this cell, which is twice the average increase for the First-Class Mail class. Reducing this passthrough to 100 percent would require a more significant 4.7 percent increase, or roughly three times the First-Class Mail average. In determining not to reduce this passthrough further, the Postal Service was particularly concerned with the historic instability of estimates of avoided cost. Indeed, between Docket Nos. ACR 2007 and ACR 2012, the reported cost avoidances for this price cell were 2.5, 2.9, 2.4, 2.7, 1.9, and 1.1 cents. Developing prices by tracing these year to year movements sends inconsistent pricing signals to mailers, potentially causing inefficiencies in postal operations.

2. AADC Automation Cards:

Based on Order No. 1793, in Docket No. RM2012-6, the Postal Service is using a weighted average cost for AADC and 3-Digit Automation Cards to calculate the cost avoidance. The resulting cost avoidance is 1.0 cent, compared to the cost avoidance of 1.3 cents reported in the FY2012 ACD. The Postal Service has given AADC Automation Cards an above-average price increase of 2.8 percent, enough to increase the passthrough for AADC Cards to 100 percent if calculated based on the actual AADC cost avoidance (rather than the weighted-average

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cost for AADC and 3-Digit Auto Cards). Setting the passthrough to 100 percent based on the new (weighted) cost avoidance would require a more substantial price increase of 4.1 percent, which is more than three times the average increase for First-Class Mail.

In determining to leave this passthrough above 100 percent, the Postal Service was careful to consider the recent methodological change for calculating avoided costs and the historic volatility in the cost avoidance. Indeed, the cost avoidance for this price cell has vacillated between 1 cent and 1.3 cents every year since the FY2007 ACD. Based on these two factors, the Postal Service is concerned that implementing a more substantial price increase in the face of inconsistent avoided cost measures could send inconsistent price signals to mailers, potentially reducing the efficiency of postal operations.

3. *ADC Automation Flats:*

The Postal Service has made progress in reducing the passthroughs for First-Class Mail Automation Flats since the methodological change adopted in Docket No. RM2008-2 (Proposal 8). The discounts for Automation Flats are evaluated using cost avoidances reported in *FY2012 FCM Prst Flats PRC2.xls*, which the Commission posted on its website on March 28, 2013.

The passthrough of the avoided cost for the ADC presort level for flats is 112.3 percent, a reduction from the current 158.7 percent (2012 ACD, at 87, Table VII-4). This improvement is the result of: 1) an increase in the estimated cost avoidance from 5.6 cents to 8.1 cents; and 2) a reduction of the discount

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from 10 cents to 9.1 cents. However, cost avoidance for ADC Flats has been fairly unstable over the years, vacillating between 13.8 cents and 4.4 cents since the FY2007 ACD. Further reducing the discount to move the passthrough to 100 percent would require a price increase of 4.5 percent, almost three times the average increase for First-Class Mail. The Postal Service is concerned that adjusting prices further, solely in response to historically volatile cost avoidance estimates, could impact the efficiency of postal operations by sending inconsistent price signals to mailers.

Standard Mail

4. Nonautomation ADC Nonmachinable Letters:

The passthrough for presort nonmachinable ADC letters compared to nonmachinable mixed ADC letters is 116.3 percent. In Docket No. R2012-3, which used FY 2010 ACD avoided cost data, the Postal Service aligned the 9.7 cent presort discount for nonmachinable ADC Letters with the avoided cost for nonmachinable mixed ADC letters. In Docket No. R2013-1, the Postal Service decreased this discount to 9.5 cents. In the current price adjustment the Postal Service has decreased this discount further, to 9.3 cents.

Since Nonautomation ADC letters have already received a 2.3 percent increase in this Docket, and since the avoided cost for this discount have been historically erratic,² the Postal Service does not believe that the discount should be lowered below 9.3 cents at this time. Indeed, were the Postal Service to

² Avoided cost decreased from 11.1 cents in FY 2010 to 7.9 cents in FY2011, and increased to 8.0 cents in FY2012.

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reduce the passthrough to 100 percent, mailers would be confronted with a 5.0 percent price increase. This price increase, based solely on unpredictable avoided cost measures, could cause mailers to change their behavior in unanticipated ways, resulting in inefficient postal operations.

5. *Nonautomation 3-digit Nonmachinable Letters:*

The passthrough for presort nonmachinable 3-digit letters compared to nonmachinable ADC letters is 114.8 percent. In this price adjustment, the Postal Service has decreased the discount for presort nonmachinable 3-digit letters to 3.1 cents. However, avoided cost for nonautomation 3-digit nonmachinable pieces has been historically volatile, decreasing from 5.6 cents in Docket No. R2012-3 to 2.5 cents in R2013-1 and increasing to 2.7 cents in the 2012 ACD.

Given the volatility of avoided costs and the fact that Nonautomation 3-digit letters have already received an above average price increase of 3.2 percent in this docket, the Postal Service does not believe that the discount should be reduced below 3.1 cents at this time. Indeed, were the passthrough to be reduced to 100 percent, mailers would receive price increases of up to 7.2 percent. The Postal Service believes that a sudden price increase of this magnitude could impact the way mailers enter mail under this category, thus impacting the efficient operations of the Postal Service.

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6. *Automation 5-digit Flats:*

In the Docket No. R2013-1 price adjustment, the discount of 9.3 cents for automation 5-Digit flats was well below the avoided cost of 11.7 cents.³ Since that case, however, the avoided cost has dropped to 8.7 cents.⁴ In this price adjustment the Postal Service has lowered the discount to 9.2 cents. Given this sudden drop in avoided cost, and the uncertainty over whether the avoided costs will continue to vacillate, the Postal Service is concerned that a sudden and substantial adjustment to the discount could send confusing price signal to mailers, possibly causing changes in mailer behavior. Such unanticipated changes could impact the efficient operations of the Postal Service. .

7. *Nonautomation 5-digit Flats:*

In the Docket No. R2013-1 price adjustment, the Postal Service aligned the presort discount for nonautomation 5-Digits flats with the avoided cost. However, since that price adjustment, the avoided cost dropped to 5.8 cents.⁵ In this filing the discount is being lowered to 7.4 cents, resulting in an above average price increase of 2.3 percent for nonautomation 5-digit Flats. If the Postal Service were to align the discount for nonautomation 5-digit flats with the avoided cost, the percent increase for these pieces would be as high as 7.0 percent. The Postal Service believes that a price increase of this magnitude could impact the

³ Docket No. R2013-1, United States Postal Service Notice of Market-Dominant Price Adjustment, Attachment B, at 12 (November 16, 2012).

⁴ Docket No. ACR2012, Annual Compliance Determination for Fiscal Year 2012, at 120, Table VII – 20 (March 28, 2013) (*hereafter* “FY2012 ACD”).

⁵ *Id.* The avoided cost for presort 5-digit flats has been historically volatile, decreasing from 8.2 cents in Docket No. R2012-3 to 7.8 cents in Docket No. R2013-1 and decreasing further to 5.8 cents in FY 2012.

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way mailers enter mail under this category, thus impacting the efficient operations of the Postal Service.

8. *NDC irregular parcels:*

In the FY2012 ACD, the Commission directed the Postal Service to either align the discount between NDC irregular parcels and mixed NDC irregular parcels with the avoided costs, or adequately support an applicable statutory exception.⁶

In this price adjustment the Postal Service is lowering the discount to 33.4 cents, thereby reducing the passthrough from 242.8 to 219.7 percent. This reduction results in an above average increase of 2.9 percent in this docket. The Postal Service believes that reducing the discount further would be unduly disruptive for mailers and the Postal Service, because of the ongoing changes in the nature of mailpieces sent using this price category.

Two major classification changes are at the center of the shifting characteristics of the mailpieces in this category. The first major change relates to the transfer of all Standard Mail commercial parcels to the Competitive product list, as part of Docket No. MC2010-36. As a result of this transfer, only nonprofit irregular parcels remain. The second major change relates to the elimination of the Non-Flat Machinable (NFM) category, and the introduction of Marketing Parcels, which have caused the migration of some former nonprofit NFMs to the nonprofit irregular parcels category. These two changes have opposing effects

⁶ FY2012 ACD, *supra* note 3, at 123.

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on irregular parcels volumes, but they work in tandem to change the characteristics of the irregular parcels category.

As a result of these changes, the avoided costs for NDC irregular parcels have continued to vacillate. In Docket No. R2012-3, the avoided cost for NDC irregular parcels was 14.4 cents. It decreased to 13.0 cents in Docket No. R2013-1 and increased to 15.2 cents in FY 2012. It is still not clear what final effects these changes might have on the costs and avoided costs of irregular parcels. For these reasons, the Postal Service continues to believe that it should exercise caution in making changes to discounts and other cost-based pricing until the Postal Service has a clearer picture of the costs of this changed category. The Postal Service believes that, when this transition phase is complete, stable estimates of costs and avoided costs will clarify the magnitude and direction of the changes needed to better align the discount with avoided costs. Until such time, the Postal Service believes that major changes in the discount should be avoided, so as to not encourage changes to mailer behaviors that may lead to inefficient operations.

ATTACHMENT A

Product	CPI Price Increase for Mail Class	CPI Price Increase for Category	Ratio of Category Increase to Class Increase	CPI Price Increase for Category (100% passthru)	Ratio of Category Increase to Class Increase (100% passthru)
First-Class Mail	(A)	(B)	(B) / (A)	(C)	(C) / (A)
Mixed AADC Cards	1.587%	3.10%	195%	4.77%	301%
AADC Cards	1.587%	2.80%	176%	5.70%	359%
ADC Flats	1.587%	3.00%	189%	4.50%	284%
Standard Mail					
Nonautomation ADC Nonmachinable Letters	1.609%	2.32%	144%	5.00%	311%
Nonautomation 3-Digit Nonmachinable Letters	1.609%	3.25%	202%	7.16%	445%
Nonautomation 5-Digit Flats	1.609%	2.31%	144%	6.44%	400%
NDC Irregular Parcels	1.609%	2.91%	181%	16.60%	1032%